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CITY AND COUNTY OF HONOLULU
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JEREMY HARRIS
MAYOR

March 1, 2002

The Honorable John DeSoto, Chair
and Members of the City Council
City and County of Honolulu
Honolulu, Hawaii 96813

Dear Chair DeSoto and City Councilmembers:

In accordance with Section 9-102 of the Revised Charter of the City and County of Honolulu, I submit for your consideration and adoption a balanced Operating Budget and Capital Budget for fiscal year 2002-2003 for the City and County of Honolulu.

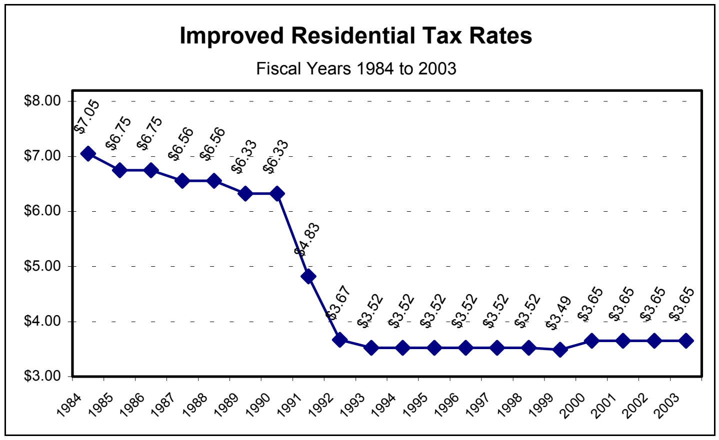
The highlights of the proposed FY 2003 Operating Budget include:

- No Increases in Real Property Tax Rates
- Apartment/Condominium Tax Cut By $3.8 million
- No Increase in Sewer Fees
- No Increase in User Fees
- All Negotiated Pay Raises are Funded

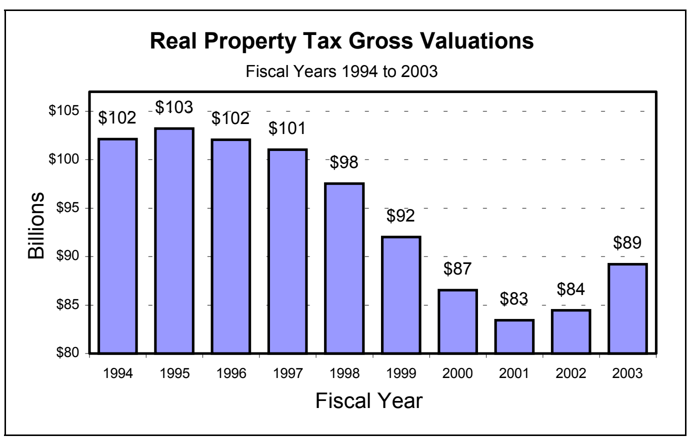
REAL PROPERTY VALUATIONS IMPROVE SLIGHTLY

Beginning in the late 1980s, real property assessed valuations in Honolulu increased annually as a result of speculative real estate investment in Hawaii. This was commonly referred to as the “Japanese bubble” economy. Following years of gradual increases, with the sudden influx of Japanese investment on Oahu, assessed valuations rose dramatically.

To compensate for the increase in real property assessed values, the tax rates for the real property classifications that were most affected by speculative real estate investments were reduced. The tax rates in most classifications were reduced substantially each year from 1988 to 1992. As an example, in 1988, the Improved Residential tax rate per $1,000 of assessed valuation was $6.56 for both land and buildings. In 1992, the real property tax rate ultimately dropped to $3.92 for buildings and $3.12 for land. These were tax rate reductions of 40 and 52 percent respectively as compared to the rate just 4 years prior.

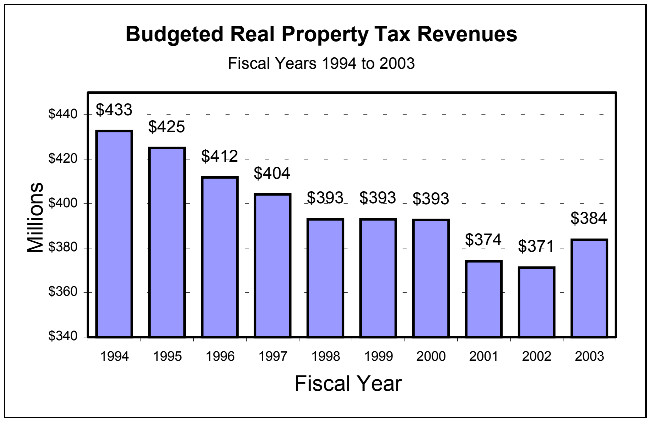


Soon after the real property tax rates were adjusted, the "bubble" burst and real property assessed valuations began plummeting. During the time when valuations rose, the tax rate was cut to reduce the burden on our residents. However, when valuations fell and the local economy worsened, we maintained the tax rates at their low levels.



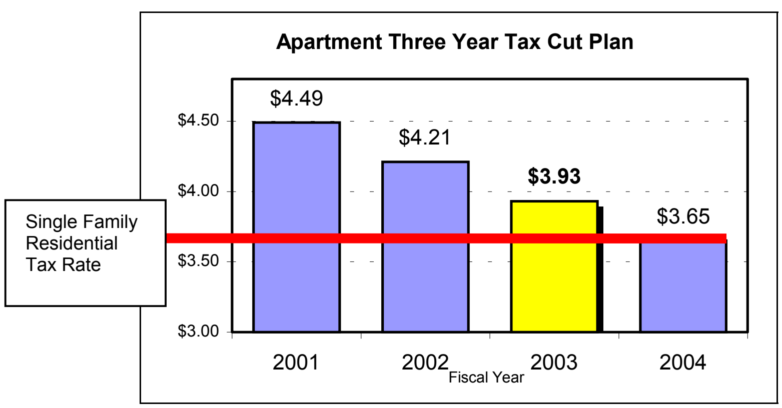
Since 1994, the City has endured tremendous losses in revenues due to the lowered assessed valuations. Assessed valuations realized their lowest point in FY 2001 when they bottomed at $83 billion with corresponding revenues of $374 million. As we enter the new millennium, we believe that we are experiencing a recovery in the real estate market for the first time in nearly a decade.

For FY 2003, with the slight recovery of the depressed real estate market, the tax revenues will increase by $13 million. The City's tax revenues will be $384 million or 6 percent over last fiscal year. Despite this increase, the City and County of Honolulu is still faced with having to provide more services with $49 million less in property taxes than it had in FY 1994.



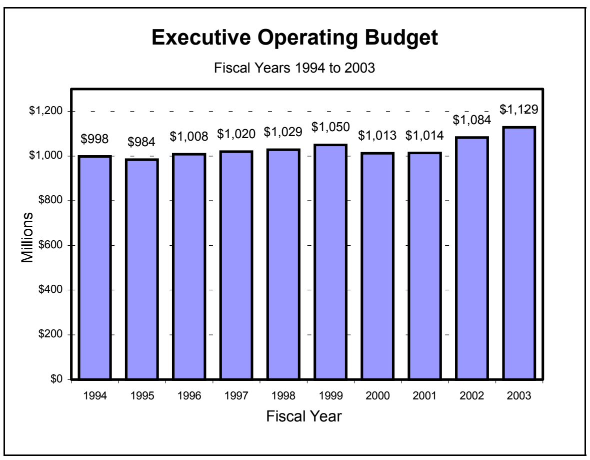
For fiscal year 2002-2003, the City continues to face many of the same challenges as in previous years. We are meeting the needs of this fiscal year without any increase in real property tax rates, sewer fees or user fees and without layoffs. The proposed budget also includes full funding for collective bargaining pay increases.

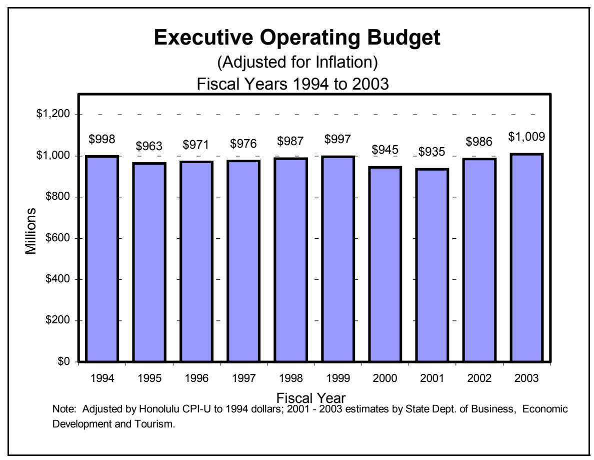
We are recommending the continuation of the three-year plan to cut the real property tax rate for apartment and condominium owners. FY 2003 will be the second year of this three-year plan and it provides for another reduction of 28 cents per thousand dollars of assessed value. This represents a total reduction of 12.4 percent thus far. The overall reduction for the three years is 18.7 percent. The goal of this program is to achieve an equitable real property tax rate for single-family homeowners and apartment owners by FY 2004.



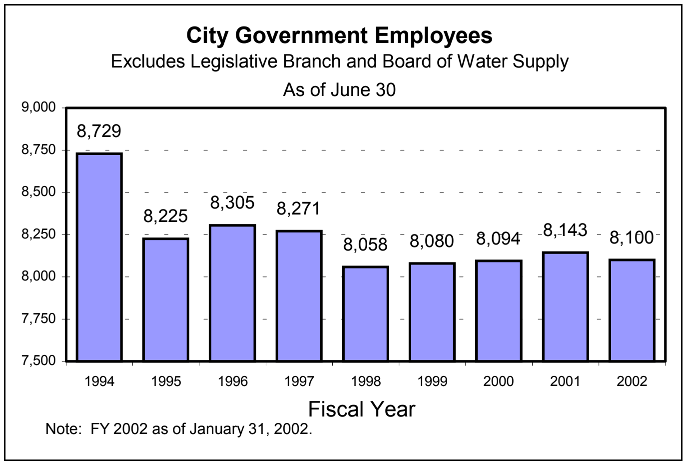
OPERATING BUDGET

This year's Operating Budget reflects the same fiscal restraint in spending as in years past. The FY 2003 Operating Budget is $1.1 billion and is $37 million more than FY 2002 or an increase of only 3.4 percent. Thirty four million dollars of the increase in the budget is for negotiated salary increases of $24 million, Health Fund increases of $4.6 million, FICA increases of $1.9 million, Workers Compensation increases of $1.6 million, Risk Management increases of $1.4 million, and Judgment and Losses of $1 million. To fund such increases, we substantially reduced the number of funded positions by continuing to closely review all vacant positions, taking advantage of attrition, and using technology and other innovations to reduce salary costs. These actions were necessary to keep costs down while maintaining our expected level of service to the public.



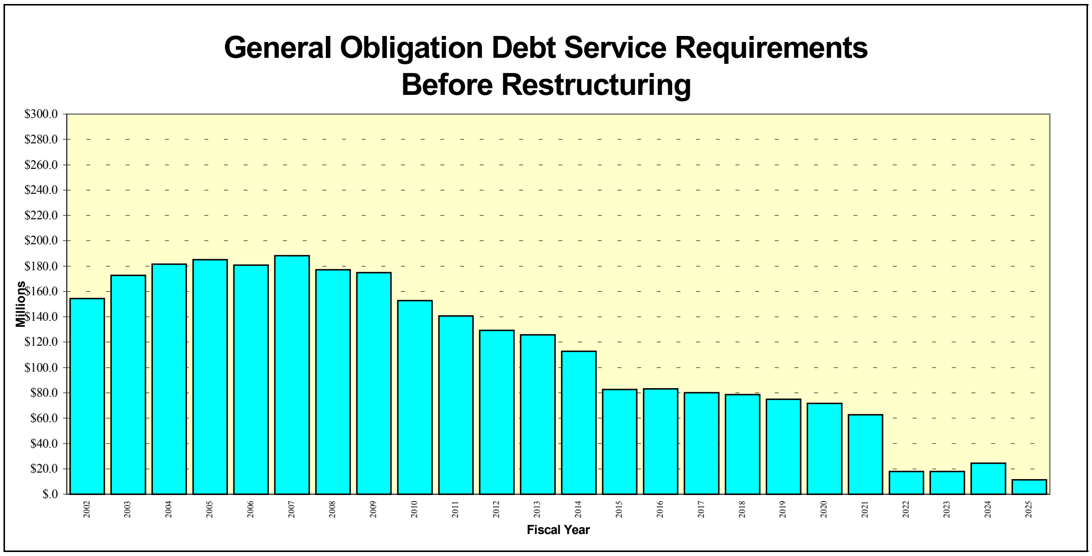


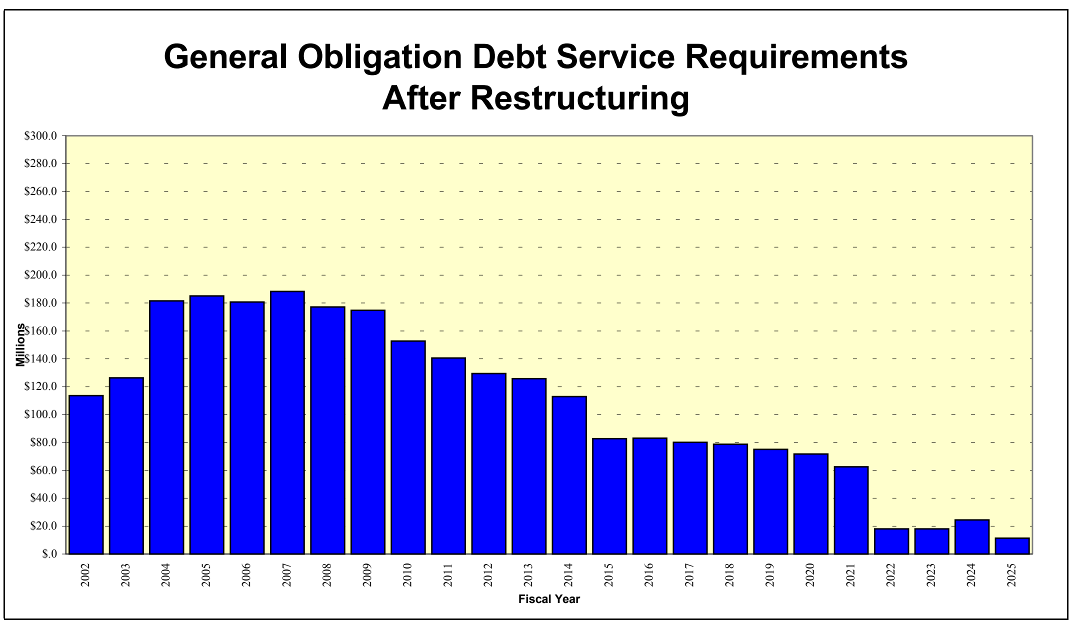
We have been able to balance the budget by controlling our operating expenses through a combination of spending cuts and debt restructuring. As a result of the many initiatives we have undertaken since FY 1994, the City has reduced the number of overall City employees by 7 percent despite marked increases in Police, Fire, and Emergency personnel. It is to the credit of our City's workers that we are able to provide increased and improved services during these difficult economic times with far fewer employees.



DEBT RESTRUCTURING

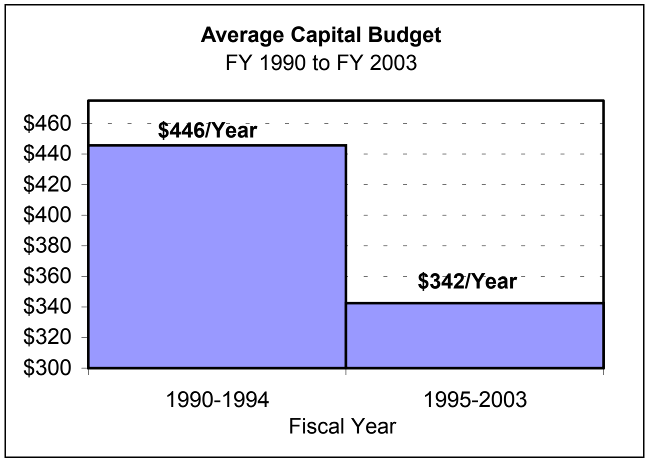
Economic circumstances logically drive financial decisions. In the 1980s and the early 1990s when the City's real property tax revenue was increasing each year, because of the Japanese bubble economy, the aggressive strategy of retiring debt early through the issuance of General Obligation (G.O.) bonds with level principal amortization over a 20-year term was manageable. During this boom period the City received real property tax revenues in the neighborhood of $425 million to $433 million annually. This accelerated payment approach is similar to opting for a 15-year mortgage on a home instead of a 30-year mortgage. Unfortunately, economic circumstances worsened over the course of the 1990s. While property tax revenues dropped steadily from FY 1995 to FY 2001 due to declining assessed valuations and lower tax rates, non-controllable expenses rose (Health Fund, Employees' Retirement System, and salaries), thereby further increasing pressure on the City's budget.





CAPITAL BUDGET

The FY 2003 Capital Budget as submitted, totals $475.5 million compared to $579 million in FY 2002, a reduction of $103.5 million.



The FY 2003 Capital Budget focuses on investing in our future with projects essential for improving the quality of life for all our residents and visitors. The major emphases of this budget are on wastewater collection and treatment systems, solid waste management, and transportation. Community involvement through the Neighborhood Board and Community Vision Process has helped to shape the Capital Budget.

Some of the highlights of the major initiatives included in the FY 2003 Capital Budget include:

$155.1 million for wastewater system improvements. These improvements are necessary to meet the City's obligations to maintain and improve the sewer systems. The most significant project includes approximately $94.9 million for improvements to the Sand Island Treatment Plant. These improvements are required to keep the City's sewer system in compliance with clean water standards.

$6 million for the H-POWER facility expansion. As our population increases, so will our waste stream. To reduce our need for landfill space, this project will increase H-POWER capacity by 50 percent and will reduce the amount of waste we send to the landfill by 80 percent.

$8 million for a recycling technology park. We are proposing to acquire land that will host a recycling technology park. Facilities will be built on this property that will include a municipal solid waste separation plant. Recyclable and combustible materials will be extracted thereby reducing our landfill needs. We will also be using portions of the land to develop public/private partnerships to implement cutting-edge alternatives for waste disposal.

$65 million for transportation improvements and construction of the Bus Rapid Transit (BRT) System. We will begin the development of our island-wide transportation plan with the first phase of our Bus Rapid-Transit (BRT) system. Our goal is to have the first section, from Iwilei to Waikiki, operational in less than three years.

For our roadways, we are providing $5 million for the North-South Highway to provide traffic relief for the residents of the Ewa Plain and $3.4 million for the final phase of the Waianae Coast emergency reliever road.

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We look forward to working with the City Council in the development and implementation of the fiscal year 2003 Operating and Capital budgets With the committed effort of the City Council, along with the involvement from the Neighborhood Board members and the Visioning process with concerned citizens, we will all share in shaping the vision of our future.

Sincerely,

JEREMY HARRIS
Mayor